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Banking on it: Investment banks as the next step for impact investing

Mitchell Laferriere
mlaferriere1@fordham.edu

By Mitchell Laferriere

BANKING ON IT

Investment Banks as the Next Step for Impact Investing

Investment banks are in a unique position to lead in impact investing and resolve some of the biggest challenges facing the space today, due not least to their vast reserves of capital and clout. Chief among these challenges are: 1) a drought of growth capital for social enterprises; and 2) the lack of a consistent impact measurement system for use by investors. Investment banks are in a position to solve these challenges by both consolidating impact accounting standards and mobilising significantly more capital in investments that seek social, environmental and financial returns.

Though the practice of impact investing began nearly two decades ago, it was not until recent years that it gained prominence. Advances in digital technology and increased interconnectivity have given rise to a generation of socially aware individuals.[1] With social and environmental issues constantly amplified by mainstream news, global movements have arisen to address these problems—movements often led by what are known as social entrepreneurs. Sometimes, they establish social enterprises (SEs), understood broadly as businesses that produce positive social and environmental outcomes. The growth of SEs in recent years has led to a demand for purpose-driven investment capital focused on achieving social or environmental impact alongside financial returns.

For their size, investment banks have comparatively little to do with the rising practice of impact investing. They make up only nine per cent of all assets under management (AUM) in the impact investment industry.[2] That totals about US$1 trillion in investments in an US$11 trillion market.[3]
For the most part, the world of impact investing is managed by individual fund managers and diversified financial institutions (DFI), but investment banks have the capacity to repair some of the biggest challenges in the impact investing industry. Investment banks in particular have an unparalleled opportunity to supply much-needed capital while instilling proper structure in terms of impact measurement.

For the last three years, investors and business owners have named

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insufficient capital as the number one problem facing SEs.[4] Like any start-up, SEs require capital to scale up. In most cases, angel impact investors—affluent individuals who provide start-up funding, usually in the form of grants, convertible debt or ownership equity—have the seed and early-stage capital support covered. However, what SEs need after this point is capital from non-concessionary investors, i.e. those who are not willing to lose returns for impact. These investors generally provide the required capital for investment at the scale and growth stages of a start-up, when the business is about to be profitable.[5] And just like any business, SEs need to appeal to these non-concessionary investors in order to tap into their large pools of growth-stage capital.

Put simply, investment banks have funds that could be used to scale social enterprises. Of course, investing for social and environmental impact can and does produce a financial return on investment at or above market rates. [6] More importantly, the scaling of SEs can catalyse an entire market environment through the opening up of new supply chains and consumer markets, creating positive spillover effects for other enterprises.[7] Beyond attaining financial returns from the SEs that scale up and become profitable, investment banks can catalyse the growth of entire markets by injecting strategic capital and refining impact investing processes.

Currently, the impact investment market is having some difficulty measuring and analysing social and environmental impact. This problem stems from impact's varying nature. When impact spans so many different sectors—education, housing, energy, clean water, poverty, and many others—there are therefore widely differing measurements for success. And while some business solutions can help to catalyse a market, the question remains: how can its market- or sector-wide impact be measured? Moreover, with many different bodies vying for the authority to create an all-encompassing system to measure impact,[8] this has led to non-consolidation of measurement systems among impact investors in general.

Investment banks can solve this problem by voting with their capital. Useful evaluations of risk, return and impact demand consistency,[9] so the banks will require a set of level metrics to evaluate these businesses. If one consistent set of standards and procedures, like the Generally Accepted Accounting Principles (GAAP), can be used to record and report social and environmental impact across all social enterprises, then that impact can be communicated and compared across businesses and investors. This is a critical precondition of any investment market that can source and allocate capital with efficiency and transparency.[10] Investment banks are in a unique position to lead by using their field-wide influence to establish one set of level metrics, consolidate the field, and streamline the process of impact investing.

I believe that impact investing—financial investing that incorporates people and planet—is truly the way of the future. For investment banks to remain competitive, they will need to change the way they view investing. They can do so by seizing this unique opportunity to play a leadership role in the impact investing space.

Mitchell Laferriere *was a Summer Research Associate at the Lien Centre for Social Innovation. During this time, he studied the theory, strategy and developmental curriculum for the teaching of impact investing to university students. His primary research interests cover impact investing, sustainable finance, social entrepreneurship and social innovation. Presently an undergraduate at Gabelli Business School at Fordham University, Mitchell is originally from Londonderry, New Hampshire, where he attended Boston College High School. He can be reached at* ***Mlaferriere1@fordham.edu***

Notes

1 Nielsen Press Room, "Global Consumers Are Willing to Put Their Money Where Their Heart Is When It Comes to Goods and Services from Companies Committed to Social Responsibility", Nielsen Market Research, 17 June 2014, at http://www.nielsen.com/us/en/press-room/2014/global-consumers-are-willing-to-put-their-money-where-their-heart-is.html

2 Abhilash Mudaliar, Hannah Schiff and Rachel Bass, "Annual Impact Investor Survey", *2016 GIIN Annaul Impact Investor Survey*, May 2016, at https://thegiin.org/assets/2016 GIIN Annual Impact Investor Survey_Web.pdf, p. 33.

3 Global Impact Investing Network, "What You Need to Know About Impact Investing", at https://thegiin.org/impact-investing/need-to-know/#s1

4 Mudaliar, Schiff and Bass, "Annual Impact Investor Survey", p. 33.

5 Paul Brest and Kelly Born, "Unpacking the Impact in Impact Investing", *Stanford Social Innovation Review*, 14 August 2013, at http://ssir.org/articles/entry/unpacking_the_impact_in_impact_investing

6 Cambridge Associates and The Global Impact Investing Network, *Introducing the Impact Investment Benchmark* (Boston, MA: Cambridge Associates, 2015), at https://thegiin.org/assets/documents/pub/Introducing_the_Impact_Investing_Benchmark.pdf

7 Ibid

8 Mark Florman, Robyn Klingler-Vidra and Martim Jacinto Facada, "A Critical Evaluation of Social Impact Assessment Methodologies and a Call to Measure Economic and Social Impact Holistically through the External Rate of Return Platform", *LSE Enterprise Working Paper* #1602 (February 2016), at http://www.lse.ac.uk/businessAndConsultancy/LSEConsulting/pdf/Assessing-social-impact-assessment-methods-report.pdf

9 Yasemin Saltuk and Ali Idrissi, "A Portfolio Approach to Impact Investment: A Practical Guide to Building, Analyzing and Managing a Portfolio of Impact Investments", *Global Social Finance* (1 October 2012).

10 Clay Shirky, "How Priceline Became a Real Business," *Wall Street Journal*, 13 August 2001, A-12.